Thomas D. Patrick
9 E. Montgomery Street
Baltimore, Maryland 21230
(410) 539-6316

June 8, 2005

Acquisition Advisory Panel and Staff
Ms. Laura Auletta
Designated Federal Officer

VIA EMAIL: laura.auletta@gsa.gov

Dear Panel and Staff:

Enclosed is our preliminary set of views and recommendations on revisions to U.S. Federal procurement having to do with some improvements regarding interest.

In essence, we suggest a few reforms which should greatly improve fairness, commercial comparability, and regulatory consistency, as well as efficiency in our Government procurement.

Simply stated, "interest is an economic truth." Just about everyone over age 13 or 14 knows it.

Among other things, we seek to bring the Government's commercial comparability for interest and its special immunity against interest into the 21st Century.

We look forward to the opportunity to present our recommendations and especially to hear your questions. It is expected we will learn. Our paper will be revised from those questions.

Thank you in advance.

Very truly yours,

Tom Patrick

Thomas D. Patrick

Statement To The Acquisition Advisory Panel
June 14, 2005

The Need For Regulatory And Statutory Reform To Provide For More Equitable Payment Of Interest In Disputes, Claims And Similar Situations

Presented by:

Alan V. Washburn

Alan E. Peterson

Thomas D. Patrick

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I. Opening Remarks: Interest Is Economic Truth, But The U.S. Government Too Often Ignores This Truth In Dealings With Contractors

Virtually every merchant, businessperson, tradesman, accountant, academic and economist in the United States[1] believes that interest, or financing cost, must be recognized in order to measure properly the cost of capital, advance of funds, or loan made over time, or, in simplest terms, when a delay occurs in the receipt of money. As renowned educator and author on costs, Professor Charles Horngren, said long ago on interest as a cost:

> Interest is the cost of using money. It is the rental charge for funds, just as rental charges are made for the use of buildings and equipment. Whenever a time span is involved, it is necessary to recognize interest as a cost of using invested funds. This applies even if the funds in use represent ownership capital and if interest does not entail an outlay of cash.[2]
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> Emphasis added.

Indeed, the concept aptly described by Professor Horngren and one so integral to today's business conduct as well as life in general, is well understood by the average "person on the street," too. Everyone who has purchased a house, bought a car, or who has a credit card understands that when funds are advanced or payment is delayed, interest applies. And, in the commercial world, whenever a significant delay occurs for an amount otherwise owed, interest is routinely assessed against the entity failing to make the payment. Interest as a real cost is economic truth.

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[1] And, many non-business persons.

[2] Charles T. Horngren, Cost Accounting, A Managerial Emphasis, Prentice Hall, Inc. 1967, p. 468. Professor Horngren—now Emeritus at Stanford University—feels the same way today.

Astonishingly, though, the U.S. Federal Government, in its capacity as the world's largest purchaser of goods and services—both as a matter of regulatory policy and as a result of real ambiguity in various statutes and case decision outcomes—avoids payment of interest on amounts otherwise acknowledged, or judicially determined, to be Federal Government debts.[3] The resulting subsidy of the Federal Government by its suppliers and others who engage in Federal transactions is unconscionable, in and of itself. Such a "free ride"[4] also adversely affects our nation's procurement objectives by discouraging companies from competing in the Federal marketplace and depriving those, that must go through a disputes process to try to collect monies otherwise owed, of the funds needed to hire workers, invest in plant and new technologies and become stronger competitors in the international, as well as the national marketplaces.[5]

The interest cost hardships which U.S. Federal Government interest policies impose on small businesses are especially egregious.[6]

[3] The Federal Government has no problem recovering interest when a delay occurs in amounts owed to it. Look no further than the Internal Revenue Code for businesses as well as individual citizens for proof.
[4] Holding someone else's money without interest is proof of the "free ride."
[5] Procurement rules as well as procurement attitudes affect important market decisions. For example, when the U.S. Government would not adequately reward contractor investment in capital equipment (e.g., interest recovery), the U.S. Defense Industry became slow to add labor saving plant and equipment; that is, until Cost Accounting Standards 414 and revisions to guideline pricing for financing plant and equipment investments became regulatory rule as well as regulatory pricing practice.
[6] The presenters know this to be true from their practice as well as from studies and Congressional pressure for more competition and commercial comparability.

II. Summary

A. A Few Examples Of Inequities And Unfairness From The Government's "Free Ride"

Following, the presenters set forth in greater detail some of the inequities involving interest occurring today, together with a few illustrations and examples. We also provide some recommendations to try to correct the problems and to improve both the Government's and the suppliers' challenges in this interest cost area.

As illustrations of some of the inequities as well as U.S. Government unfairness on interest summarized from the presenters' models herein put forward, consider these amounts:

Illustration Of The Disparity Between Real Financing Cost And Current Interest Recovery Under The Contract Disputes Act

Real Financing Costs—9% (Prime Rate Plus 3%) (From Illustration I)	
Interest During Contract Performance Period, Years 1-2	$ 23,800
Interest During Claim Preparation And Certification Period, Year 3	$ 24,800
Interest During Claim Dispute Resolution Period, Years 4-6	$ 89,000
	$137,600
Contract Disputes Act Interest—4.25% (Treasury Rate) (From Illustration II)	
Interest During Claim Dispute Resolution Period, Years 4-6	$ 33,700[7]

The disparity of recovery is great.

B. When The U.S. Government Wants Its Money Back, It Applies Different Rules So That Its Refunds Include Interest; Such Double Standards Cannot Be "Fair"

In U.S. Government contract situations involving what is most often called "defective pricing" (also called Truth In Negotiation Act or TINA violations) or Cost Accounting Standards violations, our Government wants early-starting interest on the increased costs paid by the Government.

[7] Claim profit in the model is $24,000; claim profit is for management skills applied and risks taken and is not relevant to claims interest.

When taxpayers fail to pay the proper amount of tax on time, our Government wants interest starting when the tax amount was due.

Thus, in these two circumstances, the Government reverses its position on interest from what it allows contractors—and gets interest on the monies owed the Government.

C. Some Ways For More Fairness By The U.S. Government

The presenters are aware of the many challenges that administratively would follow from trying to identify a precise interest cost contractor by contractor and situation by situation. And, currently, different interest rates are used by the Government when it pays contractors interest pursuant to the Contract Disputes Act compared to when the Government collects interest in various circumstances like procurement regulation and Internal Revenue Code violations. Hence, the presenters propose that a rate more uniform is desirable.

Accordingly, it is appropriate and timely for our Government to step forward and deal with these interest challenges more fairly. The presenters urge the Government to select a) the Prime Rate (see Table above) for contractor claims or some other more realistic rate such as the one used for large corporate tax underpayments or b) the U.S. Treasury Rate (also see Table above). This recommendation would address the rate shortfall portion of fairness. And, at the same time, the presenters also urge the Government to start the time of interest determination at the point of, or close to, increased contractor investment, a reasonably early-starting recovery. This recommendation would also address the timing portion of fairness.

Then, Congress should also pass legislation making clear contractors' entitlement to interest as suggested herein.

D. Expanding Interest Recovery Would Enhance Fairness And Comparability With Commercial Contracting And Can Be Easily Accomplished

The Acquisition Advisory Panel (the "Panel") Charter states a goal of "promoting the effective, efficient and fair award and administration of Federal Contracts." Bringing the Federal Government's liability for financing costs incurred by its contractors more closely into alignment with the liability of other buyers would significantly contribute to the Panel's goal—importantly, in this one

area of interest cost, without requiring sweeping changes to existing pricing regulations (e.g., in the Federal Acquisition Regulation) and would be achievable as well as simple and fair.

The presenters assert here that introduction and use of the Payment of Interest On Contractors Claims clause was easy and Contract Disputes Act interest was as well.

E. The Government's Liability To Its Contractors Should Be On Terms Reasonably Equivalent To Those Terms Applied By Business In Commercial Transactions

Congress and the Federal agencies have endorsed a general policy of seeking to make the Federal Government procure as much as possible on terms comparable to commercial transactions. The Supreme Court has chimed in, referring to the general principle that "when the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals."[8]

F. Interest Improvement Would Lead To More Efficient And More Consistent Court Decisions

Although Congress has in recent years taken important steps to permit reimbursement to its contractors for financing costs, the Federal Government continues to assert in many instances, and often to receive a special immunity to liability for interest, which immunity seems to have no justifiable basis (sometimes carelessly referred to as "sovereign immunity"). The result is often unfair imposition of financing costs on contractors and the unnecessary expenditure of time and money to litigate whether the government should be held liable—in the presence of the inconsistency of field practice as well as case decision results.[9]

[8] United States v. Winstar, 518 U.S. 839, 895 (1996). The "Winstar-related" cases are also indicative of the current inequities related to the Federal Government liability for interest. Further discussion is presented in Section III, following.

[9] Also, as stated above, interest improvement is possible and practicable. There are major U.S. sound precedents, for example—a) the 1978 Contract Disputes Act with its 1972 predecessor, the Payment Of Interest On Contractors' Claims clause, and b) prejudgment interest laws involving state commercial damages and awards in patent cases. Important Judges decry present U.S. Government practices on interest. More on these points follows herein.

G. There Are Sufficient Positive Precedents And Analogies To Encourage Proceeding In This Interest Area Now

The presenters believe there are more than enough positive interest precedents and analogies that interest improvements can and should take place now. Some of these precedents and analogies are put forth herein.[10]

[10] The presenters assume some will assert that the U.S. cannot afford the interest improvement here recommended. The short answer is that our Government cannot afford the present inconsistencies and unfairness.

III. Federal Government Policies And Special Immunities Assertions Denying Interest Liability Are Unfair And Contrary To Commercial Practices

A. Some Federal Contracts Are Not Covered For Interest And Should Receive Contract Disputes Act-like Interest Protection

The Federal Government enters into some contracts and arrangements that do not presently come within reach of the Contract Disputes Act, and the contractors, as well as the Government procurement process, thus do not get the benefit of the "interest" provision of that Act, as well as not being entitled to any prejudgment interest. Examples include:

1. "Winstar-related" cases. The Winstar cases involved allegations of breach of contract against the United States in connection with Government regulatory treatment of goodwill by Federal Savings and Loan institutions. Although plaintiffs in these cases were awarded damages for such things as lost franchise value, the plaintiffs' claims for prejudgment interest were denied as a matter of law. In one of these cases at the U.S Court of Federal Claims, the Court eloquently sets forth not only the need for interest in order for aggrieved parties otherwise entitled to recovery to be made whole, but also the need for legislative reform:

> The court understands, of course, that the award of approximately $35 million for the value of a franchise seized 12 years ago provides Franklin with far less in economic terms than it is owed. While the court is limited by the prohibition on pre-judgment interest in this case, the court believes that the award is grossly inadequate in view of the damages actually suffered by Franklin. This, of course, is a recurring problem in the Winstar-related cases, because parties who are harmed, even when able to prove damages in these difficult and novel cases, will not be made fully whole. Indeed, it is ironic that Franklin is prevented under the law from being made whole because it cannot obtain interest on its damages caused by the government's breach, but the government itself claims massive interest assessments against Franklin on the tax it contends the Franklin receivership owes.

> Unfortunately, the courts, at least at this juncture, are not the fora that can make the damaged parties whole. This represents one of those gaps in our Nation's system of the rule of law. Our great Constitution's Framers were men of extraordinary vision. They understood that while a framework for the protection of rights under the law had been established in 1789, its complete fulfillment was an ongoing project for the ages. Through statute and executive action our Nation has moved toward that goal. This is a case where the movement should continue through the legislative process.[11]
>
> Emphasis added

Thus, the Court recognized the economic reality of interest, the inequity—that some would call shameful—of not including interest as part of damages otherwise owed, and the need for legislative reform. The Panel has an opportunity to help address this problem and close the "gap" cited by the Court in the above quotation.

The Presenters believe there are other examples of similar interest recovery inequities that bear added research including 2-6, following.

2. Situations where a private company may be "buying" from the U.S. Government. Illustrative is Hughes Communications Galaxy, Inc. (Hughes) v. United States. Hughes had entered into a "Launch Services Agreement" in 1985 with the Government, under which the Government agreed to launch commercial satellites for Hughes using the space shuttle. The Government breached its contract after President Reagan determined that the space shuttle would no longer be used to launch commercial satellites. Even though Hughes was awarded over $102 million in damages, finally affirmed on Appeal in 2001, for additional costs incurred primarily prior to 1994, Hughes received no prejudgment interest. Obviously, without interest, Hughes was not made whole, similar to the Winstar situation described above.

3. Contracts involving real property. It is the understanding of the presenters that contracts for the procurement or lease of real property are not covered by the Contract Disputes Act.

[11] Smith, Senior Judge, Case No. 90-981C, C. Robert Seuss, et al., v. United States, Opinion, p. 14.

4. The Spent Nuclear Fuel cases. In Indiana Michigan Power Co. v. United States of America, 57 Fed. Cl. 88 (2003), the Government's witness believed in interest, saying:

> "...it makes sense to provide some award for the time value of money from an economic perspective..."

The Court barred the award relying on sovereign immunity and the "no interest rule."

5. Small business cases. The presenters believe the current Government denials of interest liability are especially harmful to small businesses. These smaller companies often do not have the resources to pursue judicial remedies, like a Marathon Oil, or Hughes, in the cases described herein, and the present state of Government interest law and policy acts to discourage those companies from even trying. Therefore, reported cases and similar examples of the interest inequities described herein, represent only the "tip of the iceberg"—especially for small business suppliers to our Government.

6. Other. The presenters believe that further research into arenas such as healthcare and Federal grants for colleges, universities as well as not-for-profit entities would result in additional demonstrations of the need to extend Contract Disputes Act interest protection.

These interest recovery inequities should be corrected by extending the interest protection provided by the Contract Disputes Act to a broader range of contractual transactions where the Federal Government is the ultimate payor, which extension could be done relatively easily.

B. A Recent Decision By The United States Court Of Appeals For The Federal Circuit Highlights The Current Unfairness And Misguided Statutory Interest Rules

1. The Improper Assertion Of Ambiguity

Congress has passed a statute providing for interest on "all final judgments against the United States in the United States Court of Appeals for the Federal Circuit." (28 U.S.C. § 1961 (c) (2)) Recently, a divided Federal Circuit Court found that language to be "ambiguous"; this has created a serious question whether any judgment of the Federal Circuit Court bears interest. (**Marathon Oil Co. et al. v. United States**, 374 f.3d 1123 (2004)) Congress needs to revisit this statute and make clear that "all" means "all" and that "all" is neither unclear nor ambiguous.

2. And There Is A Foolishness Involving A Special Immunity Against Interest

In Marathon and others, the Federal Government often seeks to hide behind the cloak of special immunity against interest. The inapplicability of immunity to the interest recovery issues discussed herein is more fully presented in a recent article by practitioner, legal scholar, author and your presenter here, Alan Washburn, in the Nash and Cibinic Report (April 2005), which is attached hereto as Exhibit I.[12]

C. Some Reasons Why Fairness Demands That Interest Recovery Should Begin Earlier—That Is, From The Time The Underlying Costs, Or Damages, Are Incurred

1. Contractors and others often incur costs to finance additional or changed work required by their Federal contracts and agreements, often as a result of the application of "Changes" or "Disputes" clauses, which require work to be performed even if the price of the added work is not known or is in dispute. Such

[12] The presenters note that one of the Panel members, Marshall Doke, has also questioned the Government's sovereign immunity assertions. The presenters believe their recommendations with respect to interest are consistent with the views expressed by Mr. Doke in his May 5, 2005 "Proposal for Public Comment" memorandum to the Panel's Commercial Practices Working Group.

The presenters also know the distinguished Mr. Doke, but have refrained from contacting him or discussing their interest views and recommendations until the entire Panel heard from them. This is for independence. The presenters offer to review the interest matter with Mr. Doke and others as Panel work moves forward.

additional or changed work may be associated with changes, delays, late and defective Government furnished property or late and defective information, terminations for Government convenience, etc., or any situation where a contractor or company has to contractually incur reasonable added costs on behalf of the Federal Government without appropriate reimbursement on a timely basis.[13]

There is more to improve on than simply a minor Federal Acquisition Regulation issue—for example, Contract Disputes Act interest determinations need to be extended to permit earlier interest recovery.[14]

2. When these increased cost situations occur, it is axiomatic that any interest associated with such greater costs for Government benefit is part of the cost of contract performance—most often identified as finishing the contract work, excluding warranty work. This reality was clearly recognized when Congress passed the Contract Disputes Act in 1978. The legislative history of that law contains the following discussion to the effect that interest cost for the changed work is a legitimate cost:

> The rights of Government contractors who prevail on claims against the Government are unique since they have been required by language of the contract, for example, the changes article and the disputes article, to perform the work as directed by the Government without stopping to litigate. Thus, Government contractors must perform and then argue about the amount of the equitable adjustment at some later time. Since the contractor has been compelled to perform the work with its own money—in the total absence of contract payments or progress payments—there can be no equitable adjustment to the contractor until the contractor recovers the entire cost of the additional

[13] In Federal Government contract procurement, financing costs associated with the expenditure of additional funds on the Government's behalf during contract performance (such as for a "change")—also called increased contract working capital investment—have historically been referred to as "Interest in a claim," while other types of interest recovery issues have been called "Interest on a claim (e.g., post-judgment interest). Many authors have used this distinction over the years. The presenters believe that this categorization is helpful in reviewing the history of issues involving interest recovery in Government contracting and in general, as well as for analytical understanding. However, they have not used that classification herein, since they felt that the overriding considerations involving current interest recovery from the Federal Government are primarily a question of basic fairness, entitlement, timing and measurement, without regard to whether interest is in or on a claim or is prejudgment or post-judgment.

[14] The presenters are not discussing fixed price contract overruns where the contractor is responsible for the added cost, not the Government.

> work. The cost of money to finance this additional work while pursuing the administrative remedy, normally called interest, is a legitimate cost of performing the additional work.[15]
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> Emphasis added

As indicated above, unless the contractor receives some interest allowance associated with the higher cost of performance on the Government's behalf, the contractor will not be recovering the full cost of the added expenditures or a reasonable surrogate therefore. When the Government avoids paying such interest, in essence, it forces the private party to subsidize the Government. Often such subsidies are huge, or proportionally so. No individual company, organization (e.g., a venture) or citizen serving our nation should be required to bear such a burden.

3. The Contract Disputes Act of 1978 and the "Payment Of Interest On Contractors' Claims" clause which preceded it, upon which the Disputes Act was modeled, were major developments that statutorily, regulations-wise and contractually created a more equitable arena for entities doing business with the Federal Government.[16] The more recent Contract Disputes Act requires the Government to pay interest on "certified" claims from the date that the Contracting Officer receives the claim.

4. However, even though the Contract Disputes Act was a much needed improvement, that Act does not fully provide for adequate cost recovery to enough contractors, and significant inequities, as well as inconsistencies, still occur. One fundamental problem is that Contract Disputes Act interest begins only after a claim is prepared, certified and submitted—steps that take time.[17] The result is that contractors incur significant unreimbursed interest costs; contractors have to spend their money and the Government gets some form of "free ride," which the contractors are providing at no financing cost to the Government.

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[15] Senate Report No. 95-1118, p. 5266, on what became the Contract Disputes Act of 1978, P.L. 95-563.
[16] The Department of Defense began to include the "Payment Of Interest On Contractors' Claims" clause (initially, ASPR 7-104.82) in contracts in 1972.
[17] This order of priority—that is, complete the contract work first and work on claims on a "best efforts" basis, as well as negotiate them—is reasonable. Early claims, although probably valuable to both parties (e.g., to possibly avoid some increased costs) often cannot be the highest priority—many times, a resource issue as well as a default risk issue.

5. These phenomena—from partial to no interest recovery—are shown in a simple model, Illustration 1, "Interest During Contract Performance (And Post Contract Performance Continuing Financing Costs)", Exhibit 2. This Illustration assumes (i) that a contractor incurs $10,000 per month over 24 months performing changed work on behalf of the Government, and (ii) that the contractor incurs interest cost at the current prime rate (of 6%) plus 3%, or totaling about 9%, which also is compounded monthly.[18] At the end of 24 months, the contractor will have incurred approximately $23,800 of interest cost. Then, the model assumes that it takes another year for the contractor to identify and measure the changed work costs, hire lawyers, prepare a Request for Equitable Adjustment, certify the Request, work with Government fact finders and auditors, conduct preliminary negotiations, etc. In this additional 12 months, nearly $24,800 of additional interest will be incurred, so that at the end of the three year period, the contractor will have incurred approximately $48,600 in interest costs before becoming eligible for any Contract Disputes Act interest—without interest recovery. Stated somewhat differently, the contractor has made a working capital investment for the benefit of the Government totaling $240,000 and financed that investment at a cost of approximately $48,600.

6. Illustration 1 also demonstrates the fallacy of an argument sometimes advanced to justify denying Government payment of interest cost incurred during contract performance: that the profit on claims adequately compensates the contractor for financing costs. No such thing is generally true[19]

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[18] Of course there are different interest rates for measuring finance costs in a variety of contractor lending risks and other circumstances. For the purposes of illustrating true financing costs incurred in connection with additional expenditures on the Government's behalf, which usually are incurred over periods of a year or greater, it is helpful to think of commercial interest rates as representing a spectrum: At the bottom end are short term rates, like prime, which are only available to the most credit worthy bank customers (almost always large, well established corporations and not to small businesses); at the top end are interest rates that represent the weighted average cost of capital and reflect a combination of debt and equity financing. Weighted average cost of capital rates are a function of each particular company's circumstances. Generally, they are lower for large, well capitalized firms; historically, such rates have averaged around 8-12% in the experience of the presenters. For smaller firms, weighted average costs of capital rates are higher and for small businesses, higher still. In selecting an appropriate rate for the purposes of the Illustrations contained herein, 9%, representing the current prime rate (6%) plus 3%, was considered a quite reasonable representation for all kinds of firms that do business with the Federal Government, being toward the upper end of the spectrum for large firms (based on the U.S. current interest rate picture), but well below the upper end for smaller firms and small businesses. It may be noteworthy that the current prime rate is expected by many observers to increase; for example, during most of the period 1995-2001, prime was above 8%.

[19] The presenters acknowledge that the argument that profit provides for interest on contract working capital investment has some appeal when considered in the context of original contract pricing. The current "weighted guidelines" approach used by Contracting Officers in the Department of Defense for evaluating profit even has evolved to give some limited recognition to working capital investment. However, as can be demonstrated by simple examples, such as in Illustration 1 in Exhibit 2, herein, borne out time and again in the real world experience of the presenters, profit allowances on changes and claims in dispute fail to adequately reimburse interest costs on unplanned-for working capital investments in performing changed work for the Government. This fact of life is not

and the facts are hardly arguable. Referring to Illustration 1, assuming that profit at a percentage rate of 10% of costs—a profit allowance that the presenters believe many Contracting Officers and Boards of Contract Appeals would find generous—is added to the claim principal amount of $240,000 yields $24,000. But the contractor's unreimbursed financing cost of $48,600 far exceeds the profit allowance of $24,000.[20]

And, since profit is for skills applied and risks assumed by the contractor, profit should not be considered as available to cover interest. Interest is a totally different element of changed work price and one calculated quite explicitly its own way in contract claims.

7. The presenters believe that, if anything, Illustration 1 probably understates what really happens in the day-to-day, real world of Government procurement. In reality, it often takes longer—much longer—than one year to prepare and present a certified claim to a Contracting Officer. In reality, many companies' long term debt and equity financing costs, especially those of small businesses, exceed 9%, and the current prime rate of 6% is at a cyclical low point. Further, profit is often at a lower allowance than the 10% of principal working capital cost investment (i.e., the claim costs before profit and interest) used in Illustration 1.

8. A further brief demonstration of the current state of affairs about contractor interest recovery also shows the inadequacy of profit to compensate incurred financing cost. Illustration 2, "Contract Disputes Act Interest," extends the example in Illustration 1. Illustration 2 assumes that a certified claim of $264,000 ($240,000, plus profit at 10%, or $24,000) is presented to the Contracting Officer at the end of year three, and that it takes three years to resolve the claim and for payment to be received (if anything, three years is at the low end of the spectrum of such procedures). For those contracts under the Contract Disputes Act, contractors' claims will earn simple interest recovery—again, in the real world of Government contracting, interest compounds.[21, 22] Thus,

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surprising considering: (i) such working capital investments seldom are covered by progress payments, and are often inextricably intertwined with original contract work costs and must be separately measured and priced to permit recovery; (ii) the extraordinary lengthy periods involved to obtain administrative and judicial remedies; (iii) the meager profit allowances for skills applied and risks assumed for changed work that occur in practice.

[20] All of which is over and above the non-recovery of much or all of the legal costs involved.

[21] As discussed above, many contractors of the U.S. Government are not covered by the Contract Disputes Act.

[22] Compound interest is a well recognized economic reality. For example, patent cases have provided for compound interest and 28 U.S.C. S1961(b) requires annual compounding; interest assessed by the Internal Revenue Service on unpaid tax is compounded daily; home mortgages are based on compound interest, money market earnings compound, etc.

in Illustration 2, the end of the post-certification 3-year period, the contractor will be entitled to approximately $33,700 of interest using the current Contract Disputes Act mandated Treasury Rate of 4.25%.[23] However, using a 9% rate (current prime rate plus 3%)—a much more realistic rate, though in reality probably still understated for many companies (see footnote 18, supra)—the contractor, at the end of year 6, will have incurred total interest cost of almost $138,000 (see Illustration 1, Exhibit 2). Hence, the contractor's true interest cost dwarfs anything the contractor can expect by way of profit and current Contract Disputes Act interest combined.

9. Illustration 1 additionally demonstrates the gross inequity occurring when a party is entitled to payment for a claim, cost recovery or "damages" from the Federal Government and no interest at all is included in Government reimbursement, even though the period of time between the start of the Government-responsible harm and eventual payment is lengthy. For example, as shown in Illustration 1, the financing costs on a cumulative expenditure of $240,000 for changed or extra work at 9% interest compounded monthly is:

During Contract Performance Period, Years 1-2	$ 23,849
During Claim Preparation And Certification Period, Year 3	$ 24,751
During Claim Dispute Resolution Period, Years 4-6	$ 89,075
	$137,675

If it took another 7 years for the above contractor to be paid, as happened in the Winstar case mentioned previously, or 13 years in total, an additional $327,000 of unreimbursed interest would accrue, resulting in total financing cost of some $465,000, eclipsing the entire initial working capital investment of $240,000 by almost two times.[24]

10. To try to remedy the inequities illustrated above, the presenters suggest that:

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[23] The "Treasury Rate," as the name implies is based on the cost of borrowing by the U.S. Government. Hence, the Government payment of simple interest using this rate will always be lower than the real financing costs associated with changed or extra work incurred by private parties. The Government, however, has no trouble using interest rates closer to those of the commercial market place when it assesses or collects interest. For example, the Internal Revenue Service rates of interest that taxpayers must pay on underpayment of taxes are currently 6% for individuals and 8% for large corporate underpayments.

[24] There are enough long periods of non-payment of interest on the record which get interest relief among the several Winstar cases, the space launch case of *Hughes,* the A-12 aircraft termination issues, etc. Nonetheless, these large cases' interest carrying periods are often longer than the instances of non-payments to small contractors.

(i) The Contract Disputes Act should be revised to require that interest be paid starting from the dates that the costs are reasonably incurred, rather than when the Contracting Officer receives the claim.[25,26] This remedy would also address the concern expressed by some that contractors could potentially today get a windfall under the Contract Disputes Act interest provisions by receiving interest on claimed amounts that include estimated, rather than incurred costs (even though in the opinion of the presenters, the risk to the Government of significant such windfall payments is not great).

(ii) The Federal Acquisition Regulation 31.205-20, "Interest and other financial costs," which generally makes interest an unallowable cost in pricing of contract adjustments, should be amended to permit Contract Disputes Act-like interest in Requests for Equitable Adjustments and similar claims. Revising this Federal Acquisition Regulation provision will improve and correct the kinds of inequities illustrated above in those cases where Contract Disputes Act interest presently does not apply—for example, settling a changed work claim when there is not a dispute, or where there is no certified claim. In addition, the revision would encourage settlements and agreement on pricing without some of the administrative expense and litigation that sometimes accompanies the assertion of Contract Dispute Act claims.

(iii) As set forth above, extend Contract Disputes Act interest provisions to other types of Federal Government transactions.

(iv) Revise the Contract Disputes Act interest rate to a more realistic rate—such as Prime rate or the rate used for large corporate tax underpayments—and permit quarterly compounding.

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[25] The presenters note that other authors have made this suggestion; see Ralph C. Nash and John Cibinic, "Interest Under The Contract Disputes Act: It's Not Related To The Incurrence Of Costs," Nash & Cibinic Report, April 1997.

[26] Most generally, cash outlays are measured before and after the change—planned versus recorded data. The presenters would agree there should be a reasonable definition of costs incurred as possibly meaning: a) accrued in its general use; b) outlays, or c) some other appropriate term or terms—such as are used at a contractor location for progress payments.

D. The Fairness Of The Proposals Put Forth Above—In Essence, To Make The Government More Liable For Interest—Is Persuasively Demonstrated In Several Analogous And Related Circumstances

1. Starting the "interest clock" earlier—which could be viewed as a form of prejudgment interest—is necessary to fully reimburse private parties for costs incurred. Prejudgment interest is widely recognized as necessary to make injured or damaged parties whole.

a. Prejudgment interest, called "delay compensation,"[27] is routinely awarded in patent cases between private parties, as well as cases where the U.S. Federal Government is found to be an infringer. Judge James W. Booth noted that the U.S. Supreme Court has held that interest was necessary to achieve the legally required remedy of "entire compensation" and that "entire" was also, in the words of the Supreme Court, "intended to accomplish complete justice between the plaintiff and the United States."[28] As Judge Booth further explained, "'Delay compensation'...is now an established concept for application in patent infringement cases against the Government."[29] Thus, in patent infringement cases, it is presumptive (presumed) that the plaintiff is entitled to early-on interest as part of his or her damages as the general rule and has been held entitled to interest from the date the infringement starts.

b. Consider "takings" : Federal courts, including the U.S. Supreme Court, regularly allow interest on claims against the United States where property has been taken for federal purposes: "The Government's obligation is to put the owners in as good position pecuniarily as if the use of their property had not been taken. They are entitled to have the full equivalent of the value of such use at the time of the taking paid contemporaneously with the taking. As such payment has not been made, petition is entitled to the additional amount [interest] claimed."[30]

c. The U.S Supreme Court has recognized that prejudgment interest is usually allowed in admiralty cases, and that "The essential rationale for

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[27] This is a phrase which is clear enough in patent cases; but unfortunately the word delay has its own use in the world of government contracts where delay often means, a) physical project delay or b) late payments without regard to such things as contract performance.

[28] James W. Booth, Interest and Federal Contracts, A Perspective, Arthur Andersen & Co., 1982, p.20.

[29] Ibid.

[30] Phelps v. the United States, 274 U.S. 341, 344 (1951).

awarding prejudgment interest is to ensure that an injured party is fully compensated for its loss.[31]

d. Various states in the U.S. allow recovery for financing costs via prejudgment interest in controversies between private parties, recognizing the connections between interest and fairness. For example, the Supreme Court of Virginia has stated: "[I]nterest is allowed because it is natural justice that he who has the use of another's money should pay interest for it."[32]

e. Changing both the Contract Disputes Act and the Federal Acquisition Regulation as suggested above would move the policies in Government procurement with respect to interest recovery into greater conformity with those in the commercial marketplace that allow prejudgment interest.

2. The Government Reverses Its Position On Interest When There Are Overpayments To Contractors

Moreover, the presenters call the Panel's attention to the fact that the Government is entitled to receive interest on overpayments the Government makes as a result of contractor defective pricing (i.e., a violation of the "Truth-In-Negotiations" Act) from the date that the Government makes the overpayment. In other words, the Government is receiving interest from when the Government effectively incurs the underlying higher costs—again, the timing issue. The Government's rights to recover interest for contractor violations of Cost Accounting Standards rules are similar. Surely, contractors and private parties ought to be entitled to similar interest relief of reasonable timing when they incur higher costs on the Government's behalf.

3. The Government Wants Interest Right Away When Individuals And Businesses Do Not Pay Their Taxes On Time

The Internal Revenue Service assesses interest on underpayments of tax beginning when the tax was due. It does not wait, for example, until the Internal Revenue Service provides the taxpayer with a claim, or notice of tax deficiency. This revenue policy is certainly understandable: The Government is "out the money" beginning the day the Government should have received the tax payment. Contractors expending funds for changes, extra work,

[31] Milwaukee v. Cement Div., National Gypsum Co., 515, U.S. 189, 194-195 (1995).
[32] J.W. Creech, Inc. v. Norfolk Air Conditioning Corp., 377 S.E. 2d 605, 608 (Va. 1989), quoting an earlier decision of that Court.

etc., on the Government's behalf are likewise "out the money" at the time of the initial expenditure; and it is at that time that changed work contractors begin to incur their related financing cost. Contractors should not have to wait long periods during which they prepare and submit a claim to become entitled to interest reimbursement, or even worse, to suffer no interest reimbursement at all. Adding insult to injury, in those circumstances when the Government does pay limited interest pursuant to the Contract Disputes Act (see Illustration in paragraph III.C.8, above), it pays at the Treasury Rate, a rate that is generally lower than the rates at which the Government assesses interest when the Government is owed money. For example, the current Treasury Rate is 4.25%; the current Internal Revenue Service rate generally applied for tax underpayments and other amounts owed by contractors for defective pricing and Cost Accounting Standards violations is 6%, and the rate for large corporate tax underpayments is 8%.

4. Judges Specializing In Government Contract Procurement Law, Together With Their Decisions, Have Endorsed The Fairness Of Interest Recognition As Part Of Equitable Compensation

Decisions by the Armed Services Board of Contract Appeals, have recognized the equity and logic of awarding interest to try to more justly compensate contractors for increased cost claims.[33] Although these cases for one reason or another are no longer the controlling law, the logic exhibited by Judges such as Lane, Burg and Booth was sound;[34] applying the reasoning of those Judges against the "no interest" results of today's law and policy can only lead a reasonably even handed analyst to conclude that the current situation is greatly biased against private parties, in favor of the Government. Procurement, thus, is in need of a balancing fairness correction.

5. Other English Speaking Common Law Countries Have Recognized That Fairness Requires Payment Of Interest

a. In Canada, there has been a broad consensus that fairness requires payment of interest to make complete compensation for claims found valid in court. According to a recent book: "The overwhelming opinion today of Law Reform Commissions and the academic community is that interest in a claim

[33] Among some of the more noteworthy cases are Ingalls Shipbuilding Division, Litton Systems, Inc, ASBCA No. 17717,76-1 BCA 11851; New York Shipbuilding Co., a Division of Merritt-Chapman & Scott Corp., ASBCA No. 16164, 76-2 BCA 11979; Blue Cross Association and Blue Shield Association (In the Matter of Pennsylvania Blue Shield), ASBCA No. 21113, 82-2 BCA 15966; and Aerojet-General Corp., ASBCA No. 17171, 74-2, BCA 10863.
[34] These were highly experienced Judges in those early times; they tried.

prior to judgment is properly part of the compensatory process...Awarding interest at an appropriate rate deprives the defendant of the windfall benefit he would otherwise receive.[35]

b. The British Parliament has made the government of that country subject to the same statutes covering liability for interest in court proceedings in general—i.e., not limited to suits against the Government.[36]

When the British Government was made liable for interest, the sky did not fall. With an interest recovery improvement as suggested here, any net interest outlay cost for the U.S Government would be relatively small, offset by efficiencies and justified by the greatly increased fairness.

[35] M. Wilson, Law of Interest in Canada, pp. 128, 130 (Ontario, 1992).
[36] Crown Proceedings Act, 1947, § 24...and not limited by sovereign immunity.

IV. The Need For Both Statutory And Regulatory Reform On Interest Is Great For Fairness, For More Comparability Of Law As Well As More Efficiency

A. Fairness Calls For Interest Improvement

The preceding discussions and illustrations highlight the overarching principle of the presenters' Statement: Fairness demands that the policies on interest in Government procurement be improved.

The current interest recovery situation, both by application of Government design and uneven judicial interpretations, cause those doing business with the Government to bear a cost that "belongs" to that same U.S. Federal Government. The interest remedies suggested herein do no more than squarely place responsibility for some increased interest costs on the entity that caused them and do no more than reimburse private citizens for some costs those citizens are incurring on behalf of their own Government.

If there were no underlying liability of the Government, there would be no interest due pursuant to the recommendations herein. Conversely, when the Government owes a payment, whether an adjudicated award, or a proper claim, interest would accrue. The Government is the super-sized customer in terms of buying power. It should not be permitted to force those doing business with it to absorb the costs that are the Government's basic responsibility; the current Government policies are tantamount to an unfair "hidden tax" on the private sector.

B. Better Dispute Resolution Would Happen

Under the current Government policies and the related statutory and regulatory environment, which allow the Government to avoid much of its interest liability, the Government benefits by foot-dragging and delay.[37] Making the corrections suggested herein should help speed resolution of disputes and reduce litigation. Better dispute resolution would improve procurement efficiency.

[37] This is not to say that contractors do not cause delays in the claims process. But such contractors are also "out the money"; accordingly, they are not benefited by their own delay and are likely hurt; because, the Government arbitrages (underpays) the rate of interest owed to its contractors.

V. Summary Of Recommendations For Interest Improvement

A. A Few Law, Regulation And Practice Revisions Are Possible

The presenters make the following specific recommendations for the Panel's consideration:

(i) 28 U.S.C. S1961 (c) (2) should be clarified to make clear the intent that interest applies to all judgments of the Federal Circuit.

(ii) Contract Disputes Act interest recoverability protection should be extended to other situations where the Federal Government is liable to private parties.

(iii) The Contract Disputes Act should be amended to provide that interest starts from the day the increased costs are incurred either on a cash basis or a reasonable accrual basis.

(iv) Federal Acquisition Regulation (FAR) 31.205-20 should be amended to permit the inclusion of Contract Disputes Act-like interest in the pricing of all Requests for Equitable Adjustments and similar claims.

(v) Interest rates used to pay interest on Government liabilities should be revised to reflect more realistic commercial financing cost rates; quarterly compounding should be permitted.

B. Better, Stronger Government And Supplier Contracts Would Occur

These suggested revisions to present laws, regulations and policies would promote greater fairness in doing business with the Government by making the Government and the contractors more equal through commercial law and related practices. The revisions would improve Government accountability, and strengthen the capacity of the private sector to provide goods and services to our great Nation, while also enhancing the overall competitive posture of those companies that sell to the Government.

C. Economic Truth On Interest Would Help All Constituencies

Economic truth would become the rule on interest recovery.

Nash & Cibinic Report
April, 2005

Guest Appearance

THE FEDERAL GOVERNMENT'S "IMMUNITY" TO LIABILITY FOR INTEREST

Alan V. Washburn

Twice recently the U.S. Court of Appeals for the Federal Circuit has split 2- 1 in rejecting claims against the Government for interest, Marathon Oil Co. v. U.S., 374 F.3d 1123 (Fed. Cir. 2004), and England v. Contel Advanced Systems, Inc., 384 F.3d 1372 (Fed. Cir. 2004), 46 GC ¶ 422, reversing Contel Advanced Systems, Inc., ASBCA 50648 et al., 03-2 BCA ¶ 32277. In both cases, the majority referred to "sovereign immunity." The dissents show there are serious questions about the nature and extent of governmental immunity to claims for interest.

In Marathon, the Federal Circuit had earlier reversed a Court of Federal Claims's ruling that the Government had breached lease contracts and was obligated to return $78.2 million it had received for the leases, but the U.S. Supreme Court reversed, holding for the contractors, Mobil Oil Exploration & Producing Southeast, Inc. v. U.S., 530 U.S. 604 (2000), 42 GC ¶ 277. The Federal Circuit then entered judgment for $78.2 million. The Government paid that amount but denied interest on it. The contractors returned to court; the dispute centered on 28 USC § 1961(c)(2), which states in part:

Except as otherwise provided in paragraph (1) [addressing internal revenue tax cases] of this subsection, interest shall be allowed on all final judgments against the United States in the United States Court of Appeals for the Federal [C]ircuit, at the rate provided in subsection (a) and as provided in subsection (b) [giving computation rules].

The majority of the Federal Circuit ruled that, despite the phrase "all final judgments," the statutory language did not unambiguously cover the Federal Circuit's judgment for the contractors. Several arguments were given for finding ambiguity, such as the relationship of § 1961(c) to other statutes, and lack of legislative history showing congressional intent to allow interest in such a case. The majority opinion suggests that interest may not be recovered if there exists any "plausible" basis for finding ambiguity. Dissenting, Judge Prost argued that the only plausible reading of the statute was that "all judgments" meant just that, and that because the statute was clear, there was no reason to look to legislative history.

Several statutes specify federal liability for interest, e.g., 41 USC § 611 (interest on claims under the Contract Disputes Act); and 31 USC ch. 39 ("Prompt Payment Act"). See generally Chierichella & Gallacher, Financing Government Contracts/Edition II--Part II, BRIEFING PAPERS No. 04-13 (Dec. 2004). Since 1863, there has been statutory language that "Interest on a claim against the United States shall be allowed in a judgment of [the Court now denominated the Court of Federal Claims] only under a contract or Act of Congress expressly providing for payment thereof." 28 USC § 2516. Various other federal statutes, some of which were canvassed in Marathon, also deal with interest, such as post-interest on judgments against the Government. As Marathon illustrates, the statutes have become a patchwork, with different language, enacted at different times and for different purposes. This makes it easier for there to be plausible arguments in many cases that there is some "ambiguity."

In Contel, the Navy had awarded a purchase contract on a lease-to-ownership (LTO) basis, with the price including interest to compensate for payment over time. The parties had been uncertain how much equipment would be installed, so offers included unit prices, which the Navy multiplied by an estimated number of units to establish the contract price. That price was to be adjusted to reflect the units installed. By the time the equipment was accepted, the number of units was known and was below the Navy's estimate. The Navy did not adjust the contract price until several years later. The Armed Services Board of Contract Appeals found that the Navy should have adjusted the price around the time of acceptance and the delay in doing so was a breach of contract. The contractor had borrowed money during the delay to finance performance, incurring interest. The ASBCA held that such interest might be recovered as damages for the breach. On appeal by the Navy, the Federal Circuit majority said that what was sought

was not the interest component in the LTO price, but rather compensation for borrowing made as a result of the Government's "breach or delay in payment," and that interest of the latter sort was not allowable against the Government.

The majority opinions in Contel and Marathon indicated (1) that the Government has "sovereign immunity" against liability for interest, absent a waiver of that immunity by statute or contract, and (2) such a waiver must be express and unambiguous. Cited for both propositions was Library of Congress v. Shaw, 478 U.S. 310 (1986), which, like a number of other court decisions, enunciates those propositions.

Dissenting in Contel, Judge Newman seemed to question whether sovereign immunity applies to interest claims:
The basic rule of "sovereign immunity," that the ruler could not be sued without his consent, was not directed to interest, but to the underlying liability. The ancient bar to recovery of interest when there was a valid underlying obligation reflects the canonical and common law prohibitions of usury, not the divine right of kings.

384 F.3d at 1382. Judge Newman stated that "'Sovereign immunity'...should not be uncritically expanded." Id. at 1383. Both history and principle support doubts like Judge Newman's that "sovereign immunity" applies to interest claims against the Government.

Historical Aspects

As Judge Newman noted, concern over "usury" underlay medieval legal hostility toward interest. Over time that hostility abated because of the utility of interest in stimulating lending for governmental and commercial purposes. See P. Thompson, RECOVERY OF INTEREST ch. 1 (London 1985). By the early 1800's, courts in America were becoming moderately open to allowing interest against private parties. E.g., Wood v. Robbins, 11 Mass. 504 (1814). During that same period, the U.S. Government routinely rejected interest claims, citing the old disfavor of interest against private parties. As that disfavor continued to decline, the Government's rejection continued. The Secretary of the Treasury and the Attorney General developed a "stern but necessary rule" of not paying interest, even if it would have been recoverable against private parties. E.g., 1 Op. Att'y Gen. 550 (1822); 4 Op. Att'y Gen. 14 (1842); 4 Op. Att'y Gen. 136 (1842). Sometimes the statement was made that because Congress knew of the executive's practice not to pay interest, congressional silence amounted to congressional denial of interest. E.g., 4 Op. Att'y Gen. 286, 294 (1843). Rarely was any justification offered beyond saying: we don't pay interest since that is our policy, and it serves the public convenience. When, in the late 1800's, the Supreme Court began to hear and deny interest claims against the Government, the Court cited the earlier denials by the executive branch. Angarica v. Bayard, 127 U.S. 251 (1888); Tillson v. U.S., 100 U.S. 43, 46 (1879). It is difficult to find any principled basis for that "traditional immunity," which rested on grounds that were fictional or little more than the ipse dixit of Government officers.

These executive branch and court decisions did not treat the Government's immunity to interest claims as "sovereign immunity." Indeed, as late as 1947, the Supreme Court issued a landmark decision denying Government liability for interest with no mention of sovereignty. U.S. v. Thayer-West Point Hotel Co., 329 U.S. 585 (1947). Further, it is hard to understand why the Attorney General or judges would invoke a supposed intent of Congress to deny interest when the Government had sovereign immunity: if the latter applied, it would bar award of interest absent an express waiver.

Incongruence Between No-Interest Rule And Principles Of "Sovereign Immunity"

The case for denying interest on sovereign immunity grounds is at least as shaky on principle as on historical grounds. The reason lies in the oft-stated doctrine that the nointerest rule may be overcome by contract. E.g., Library of Congress v. Shaw, 478 U.S. at 317. English judges have stated the same doctrine. In re Gosman, 17 Ch. Div. 771 (1881). The U.S. Supreme Court has said that only Congress, not an individual Government officer, may waive sovereign immunity. E.g., U.S. v. Shaw, 309 U.S. 495, 501 (1940). Allowing a federal Contracting Officer to commit the United States to pay interest might be reconciled with sovereign immunity if there were a requirement that the officer have express statutory authority to commit the United States to pay interest. The Comptroller General has held that interest may be allowed by contract without such express statutory authority. Comp. Gen. Dec. B-174001, 51 Comp. Gen. 251, 1971 CPD ¶ 79.

Confining "sovereign immunity" where it truly applies would have benefits beyond doctrinal clarity. Decisions

resting on something as fundamental as sovereignty should be avoided whenever possible, just as is the rule for decisions affecting the U.S. Constitution. There may also be practical problems in treating immunity to interest as a matter of sovereignty: negotiability of Government debt instruments could be impaired if holders worry that collection of interest may be subject to the ultra-strict requirements certain court decisions impose in "sovereign immunity" cases.

Waiver

In Library of Congress, the Supreme Court indicated that statutes waiving immunity to interest must be express and must be read strictly in favor of the Government. 478 U.S. at 317-21. Yet, in U.S. v. New York, 160 U.S. 598 (1896), that Court allowed recovery of interest under statutory language that did not mention "interest," but used very general language: "the costs, charges, and expenses properly incurred." Supreme Court decisions on waiver of "sovereign immunity" are split, some reading statutes strictly in favor of the Government, others giving a liberal reading in favor of the other party. In U.S. v. Nordic Village, Inc., 503 U.S. 30 (1992), the Court tried to reconcile these cases by saying that a liberal reading is given if, but only if, Congress uses broad language of waiver.

Three grounds for finding broad waiver appear to cover most if not all claims for interest against the Government in the context of contracts. The first and most important one is that cited in U.S. v. Winstar: "the general principle that, '[w]hen the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.'" 518 U.S. 839, 895 (1996) (plurality op.) As early as 1860, a U.S. House of Representatives Judiciary Committee report called this principle "well-settled." H.R. Rep. 36-513, at 4 (1860). The Supreme Court decision on the underlying claim in Marathon reflected that principle. See Special Treatment of the Sovereign?, 17 N&CR ¶ 55. The ASBCA has applied this principle very recently:

> [T]o the extent that the government waives its immunity by doing business and entering into a contract, it does so as a party never cloaked with immunity. Indeed, when the government agrees to a contract, its rights and duties under that contract are governed by principles of general contract law. Franconia Associates [v. U.S., 536 U.S. 129] at 141 [(2002)]; E.I Du Pont de Nemours and Co. v. United States, 365 F.3d 1367, 1372 n.10 (Fed. Cir. 2004).

South Carolina Public Service Authority, ASBCA 53701, 04-2 BCA ¶ 32651, at 161,602.

Federal Acquisition Regulation 31.205-20 specifies when interest is not allowable, implying that interest is allowable in any other instance. This strongly suggests that there has been a broad waiver of sovereign immunity at least as to contracts covered by the FAR.

This broad waiver as to Government contracts has roots in old common-law doctrines about "sovereignty." While grants by the English King were ordinarily construed in the King's favor, grants made with consideration flowing from the grantee to the King were read strictly in the grantee's favor, "for the honor of the King." J. Chitty, PREROGATIVES OF THE CROWN ch. xvi (1820). One modern reflection of this approach is that disputed contract language drafted by the Government is generally read in the contractor's favor. WPC Enterprises, Inc. v. U.S., 323 F.2d 874 (Ct. Cl. 1963).

Judge Newman's dissent in Contel reflects a second type of broad waiver: when immunity has been waived to a suit for breach of contract, damages for Government breach may include any remedy that would be available against a private party. 384 F.3d at 1383.

A third possible ground of waiver is that sovereign immunity to interest is waived whenever such immunity has been waived for the underlying liability. This ground has been applied in suits against state governments. E.g., Entergy Arkansas, Inc., v. Nebraska, 358 F.3d 528, 556 (8th Cir. 2004), citing Missouri v. Jenkins, 491 U.S. 274, 281 n.3 (1991). Though Jenkins indicated that states had less sovereign immunity to interest than did the Federal Government, the Supreme Court has more recently said that the sovereign immunity of states is coextensive with that of the U.S. Government, except insofar as the Constitution otherwise requires. E.g., Seminole Tribe of Florida v. Florida, 517 U.S. 44, 69 (1996). This may have obliterated any increased immunity the Federal Government may claim compared to that accorded to states cases like Entergy.

Language in Library of Congress v. Shaw suggested that a waiver for interest must be separate from that for the underlying liability. 478 U.S. at 314. Such separateness, however, is irrelevant where there is a broad waiver and

also seems irreconcilable with the award of interest in U.S. v. New York, discussed above. The Supreme Court has said that the purpose of sovereign immunity is to shield against the indignity of the sovereign's being coerced into litigation by a private party. E.g., Puerto Rico Aqueduct & Sewer Authority v. Metcalf & Eddy, Inc., 506 U.S. 139, 146 (1993). When the sovereign has already been brought before a tribunal on the underlying claim, there is little if any additional affront to "dignity" in having to defend a companion claim for interest. The "waiver" cases cited above did not specifically involve claims for interest, but the Supreme Court has made clear that a broad waiver covers interest claims even if interest is not expressly mentioned in the statute. Loeffler v. Frank, 486 U.S. 549 (1988); Library of Congress v. Shaw, 478 U.S. at 317 n.5 (1986).

Policy Considerations

In Library of Congress v. Shaw, the Supreme Court said that "policy, no matter how compelling, is insufficient, standing alone, to waive" sovereign immunity. 478 U.S. at 321. That language indicates that "policy" may be considered with other factors. There are, e.g., policy arguments that financing costs are true "costs" deserving treatment as such, as in U.S. v. New York, discussed above. The Government has its own policy arguments against liability for interest. Space doesn't permit treatment of the pros and cons here. An excellent starting point on this aspect is INTEREST AND FEDERAL CONTRACTS: A PERSPECTIVE (1982) by James W. Booth, a former Administrative Judge.

Some Conclusions And Suggestions

Although a number of court decisions treat "sovereign immunity" as applicable to interest, a fair reading of both history and principle is that those decisions mistakenly conflate the terms "traditional immunity" and "sovereign" into "sovereign immunity." Courts would do well to minimize any such questionable invocation of "sovereign immunity."

The "traditional immunity" of the U.S. Government as a special protection for the Government was based on nothing more than conclusory statements of Government officers. It is reasonable to expect courts today to look carefully into such "traditional immunity" and invoke it only after a weighing of all factors, including all relevant policies, and a finding of specific, solid grounds for applying such immunity. There are at least three broad waiver doctrines that would apply to most interest claims in Government contract cases. Applying them would often render unnecessary any consideration of "traditional immunity." Most court decisions have failed to deal with those waiver doctrines. The majority opinions in Contel and Marathon were virtually silent about waiver, although both appear to be candidates for one or more of the waiver doctrines discussed above.

Some statutes, like the Contract Disputes Act and Prompt Payment Act have reduced some barriers to recovery of interest in some instances, but the patchwork of statutes has become a crazy quilt that may tend to promote litigation about interest. When it was adopted in 1863, the statutory language on what is now called the Court of Federal Claims permitted interest in roughly the same circumstances as those where a private party would have been liable to interest. That statute has never been modified to reflect the current general law on when interest is recoverable. Such modification appears to be in order to update the law in the spirit of the principle, said to be "well-settled" as early as 1860, of holding the Government as contractor to the same rules as private parties.

Statutes have made the British government generally subject to the same liability on interest as private parties. British court decisions on sovereignty have accorded great respect to the monarch but have also insisted that one of the royal attributes is that of being, and acting as, the fount of justice. These approaches have not produced any obvious adverse effects and are worth close attention in the United States. Alan V. Washburn

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Exhibit 2

Statement To The Acquisition Advisory Panel

Illustration I, Interest During Contract Performance (And Post Contract Performance Continuing Financing Costs)

Illustration II, Contract Disputes Act Interest

Major Assumptions (All Believed To Understate The Economic Reality Somewhat)

1. $10,000 per month is expended for changed or added work, on behalf of the Federal Government for 24 months, roughly the period of contract performance, resulting in a total increased working capital investment over time of $240,000. The change occurred early in contract performance.

2. Starting before and following after the period of contract performance, another year is devoted to identifying and measuring the changed work cost, hiring lawyers and expert advisors, preparing a Request for Equitable Adjustment, certifying the claim, working with Government fact finders and auditors, conducting preliminary negotiations, etc.

3. A profit allowance of 10% of costs is added to the changed working capital expenditures of $240,000 for skills applied and contract performance risks, resulting in a claimed added profit of $24,000.

4. A certified claim for $264,000 ($240,000, plus $24,000) is presented to the Contracting Officer pursuant to the Contract Disputes Act at the end of Year 3; it takes three more years (for a total of six years from first beginning original contract work) to resolve the dispute and for the contractor to get paid without Appeals.

5. With Appeals, in the present state of interest circumstances, the time, of course, is considerably longer and the interest costs not reimbursed grow and grow.

6. The contractor incurs financing costs at the "prime rate plus 3" or 9% effective interest, including contractor credit risk allowances, lender fees and charges; the current prime rate is 6% as of June 1, 2005 (i.e., before added costs of an effective rate). Interest is compounded monthly.

7. The "Treasury Rate" (a Government borrowing rate) of interest used for Contract Disputes Act interest is 4.25% - simple interest (the current rate as of June 1, 2005).

8. All this could and does occur for a small business Government contractor in the U.S. – commonly in the proportions, rates, relationships and investment set forth above – as well as for much larger Government contractors.

Summary

Real Financing Costs -- 9% (Prime Rate Plus 3%) (From Illustration I)

Interest During Contract Performance Period, Years 1 – 2	$23,800
Interest During Claim Preparation And Certification Period, Year 3	$24,800
Interest During Claim Dispute Resolution Period, Years 4 – 6	$89,000
	$137,600

Contract Disputes Act Interest -- 4.25% (Treasury Rate) (From Illustration II)

Interest During Claim Dispute Resolution Period, Years 4 – 6	**$33,700**[1]

[1] Claim profit is $24,000; profit plus interest related to a claim, equals $57,700, which is still woefully below realistic financing costs – without any consideration of the fact that profit must compensate for contract performance risk as well as compensate for skills applied.

Illustration I
Interest During Contract Performance
(And Post Contract Performance Continuing Financing Costs)

Exhibit 2

Amounts Incurred For Added Or Changed Work

Months	Cumulative Expenditure Before Interest	Cumulative Expenditure Including Interest	Monthly Interest At 9% (Prime Plus 3%)	Cumulative Interest (Rounded)
1	$10,000	$10,000	$75	$75
2	20,000	20,075	151	226
3	30,000	30,226	227	452
4	40,000	40,452	303	756
5	50,000	50,756	381	1,136
6	60,000	61,136	459	1,595
7	70,000	71,595	537	2,132
8	80,000	82,132	616	2,748
9	90,000	92,748	696	3,443
10	100,000	103,443	776	4,219
11	110,000	114,219	857	5,076
12	120,000	125,076	938	6,014
13	130,000	136,014	1,020	7,034
14	140,000	147,034	1,103	8,137
15	150,000	158,137	1,186	9,323
16	160,000	169,323	1,270	10,593
17	170,000	180,593	1,354	11,947
18	180,000	191,947	1,440	13,387
19	190,000	203,387	1,525	14,912
20	200,000	214,912	1,612	16,524
21	210,000	226,524	1,699	18,223
22	220,000	238,223	1,787	20,010
23	230,000	250,010	1,875	21,885
24	240,000	261,885	1,964	23,849
	Subtotal (Contract Performance Period)		$23,849	
25	240,000	263,849	1,979	25,828
26	240,000	265,828	1,994	27,821
27	240,000	267,821	2,009	29,830
28	240,000	269,830	2,024	31,854
29	240,000	271,854	2,039	33,893
30	240,000	273,893	2,054	35,947

(continued)

Exhibit 2

Illustration I
Interest During Contract Performance
(And Post Contract Performance Continuing Financing Costs)

Amounts Incurred For Added Or Changed Work

Months	Cumulative Expenditure Before Interest	Cumulative Expenditure Including Interest	Monthly Interest At 9% (Prime Plus 3%)	Cumulative Interest (Rounded)
31	240,000	275,947	2,070	38,017
32	240,000	278,017	2,085	40,102
33	240,000	280,102	2,101	42,202
34	240,000	282,202	2,117	44,319
35	240,000	284,319	2,132	46,451
36	240,000	286,451	2,148	48,600
	Subtotal (Claim Preparation Period)		$24,751	
37	$240,000	$288,600	$2,164	$50,764
38	240,000	290,764	2,181	52,945
39	240,000	292,945	2,197	55,142
40	240,000	295,142	2,214	57,356
41	240,000	297,356	2,230	59,586
42	240,000	299,586	2,247	61,833
43	240,000	301,833	2,264	64,096
44	240,000	304,096	2,281	66,377
45	240,000	306,377	2,298	68,675
46	240,000	308,675	2,315	70,990
47	240,000	310,990	2,332	73,322
48	240,000	313,322	2,350	75,672
49	240,000	315,672	2,368	78,040
50	240,000	318,040	2,385	80,425
51	240,000	320,425	2,403	82,828
52	240,000	322,828	2,421	85,250
53	240,000	325,250	2,439	87,689
54	240,000	327,689	2,458	90,147
55	240,000	330,147	2,476	92,623
56	240,000	332,623	2,495	95,117
57	240,000	335,117	2,513	97,631
58	240,000	337,631	2,532	100,163
59	240,000	340,163	2,551	102,714
60	240,000	342,714	2,570	105,285

(continued)

Exhibit 2

Illustration I
Interest During Contract Performance
(And Post Contract Performance Continuing Financing Costs)

Amounts Incurred For Added Or Changed Work

Months	Cumulative Expenditure Before Interest	Cumulative Expenditure Including Interest	Monthly Interest At 9% (Prime Plus 3%)	Cumulative Interest (Rounded)
61	240,000	345,285	2,590	107,874
62	240,000	347,874	2,609	110,483
63	240,000	350,483	2,629	113,112
64	240,000	353,112	2,648	115,760
65	240,000	355,760	2,668	118,428
66	240,000	358,428	2,688	121,117
67	240,000	361,117	2,708	123,825
68	240,000	363,825	2,729	126,554
69	240,000	366,554	2,749	129,303
70	240,000	369,303	2,770	132,073
71	240,000	372,073	2,791	134,863
72	240,000	374,863	2,811	137,675
	Subtotal (Claim Resolution Period)		$89,075	
		Grand Total	**$137,675**	

Summary Of Financing Costs:

During Contract Performance Period, Years 1 - 2	$23,849
During Claim Preparation And Certification Period, Year 3	$24,751
During Claim Dispute Resolution Period, Years 4 - 6	$89,075
	$137,675

Conclusions:

Financing costs by the end of Year 2, $23,800, are nearly equivalent to profit at 10% of the cumulative expenditures on changed work ($240,000) or $24,000.

Profit as a percentage of costs cannot and does not adequately reimburse the financing cost in "real world" changed Government contract work situations -- not by a long shot!! The two are different elements of price for changed work.

Illustration II
Contract Disputes Act Interest

Exhibit 2

Months	Claim (Cumulative Expenditure Plus Profit Of 10%) Before Interest	Claim Including Interest	Monthly Interest At 4.25% (Treasury Rate)	Cumulative Interest
37	$264,000	$264,935	$935	$935
38	$264,000	265,870	935	1,870
39	$264,000	266,805	935	2,805
40	$264,000	267,740	935	3,740
41	$264,000	268,675	935	4,675
42	$264,000	269,610	935	5,610
43	$264,000	270,545	935	6,545
44	$264,000	271,480	935	7,480
45	$264,000	272,415	935	8,415
46	$264,000	273,350	935	9,350
47	$264,000	274,285	935	10,285
48	$264,000	275,220	935	11,220
49	$264,000	276,155	935	12,155
50	$264,000	277,090	935	13,090
51	$264,000	278,025	935	14,025
52	$264,000	278,960	935	14,960
53	$264,000	279,895	935	15,895
54	$264,000	280,830	935	16,830
55	$264,000	281,765	935	17,765
56	$264,000	282,700	935	18,700
57	$264,000	283,635	935	19,635
58	$264,000	284,570	935	20,570
59	$264,000	285,505	935	21,505
60	$264,000	286,440	935	22,440
61	$264,000	287,375	935	23,375
62	$264,000	288,310	935	24,310
63	$264,000	289,245	935	25,245
64	$264,000	290,180	935	26,180
65	$264,000	291,115	935	27,115
66	$264,000	292,050	935	28,050
67	$264,000	292,985	935	28,985
68	$264,000	293,920	935	29,920
69	$264,000	294,855	935	30,855
70	$264,000	295,790	935	31,790
71	$264,000	296,725	935	32,725
72	$264,000	297,660	935	33,660
		Total	**$33,660**	

Illustration II
Contract Disputes Act Interest

Exhibit 2

Conclusions:

See Illustration I for determination of interest costs at 9%, which is a more realistic depiction of contractor financing costs. Illustration I financing costs are:

During Contract Performance Period, Years 1 - 2	$23,849
During Claim Preparation And Certification Period, Year 3	$24,751
During Claim Dispute Resolution Period, Years 4 - 6	$89,075
	$137,675

Contract Disputes Act interest is $33,660 (see preceding page); the contract profit is $24,000. Even if Contract Disputes Act interest and profit (for different elements of contract price) are combined, the total ($57,660) is nowhere near the true financing cost of $137,675 incurred by the contractor.